SOBER SECOND THOUGHTS: LITIGATING PURCHASE AND SALE AGREEMENTS IN THE ENERGY INDUSTRY

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Introduction

- **Purpose of the paper**
  - Not intended to be exhaustive
  - Overview of key areas and identification of interesting issues
  - Focus on litigation of disputes

- **The Energy PSA**
  - What makes it unique?
  - CAPL PTP used as reference

- **Key themes**
  - Evidentiary issues
  - Procedural concerns
  - PSA disputes are not straightforward to litigate!

Agenda for Presentation

- **Michael A. Marion – Part I: Interpreting the PSA**

- **Miles Pittman – Part II: Pre-Closing Disputes**

- **Blair McGeough – Part III: Post-Closing Disputes**

- **Leanne Desbarats – Part IV: Limitations on Recovery**

PART I: INTERPRETING THE PSA

"They presented us with an ironclad contract that we were able to totally reinterpret."

Contractual Interpretation

- **Disputes pre-closing and post-closing usually boil down to a contractual interpretation exercise**

- **Basic rule: "ascertaining the objective intent of the parties"**

- **What is "objective intent?"**

- **What process do courts use to ascertain "objective intent"**
  - Plain words of the contract
  - "factual matrix"

Entering the (Factual) Matrix

Factual Matrix

- **What does it include?**
  - Negotiations?
  - Documents?
  - Fact Witnesses?
  - Post-transaction conduct?

- **How can you present evidence on factual matrix?**
  - Fact evidence
    - Fact witnesses
    - Documentary evidence
      - Privilege – beware of issues relating to solicitor / client privilege due to involvement of transaction counsel
    - But must go to "objective" and not "subjective" understanding of the deal

Factual matrix in the transactional context

- **Expert Evidence**
  - Fine line on experts on industry standard, examples:
    - Expert on whether GAAP included in an agreement inadmissible
      - *Lake Louise Limited Partnership v Canad Corp of Manitoba Ltd et al,* 2014 MBCA 61

    - Evidence of experienced landman on AMIs inadmissible
      - *Hunt Oil Company of Canada, Inc v Shell Canada Limited*, 2009 ABQB 627

    - Expert on PJVA CO&Os given limited weight
      - *IFP Technologies (Canada) v Encana Midstream and Marketing,* 2014 ABQB 470

    - Expert evidence of a prominent energy lawyer given limited weight
      - *Erehwon Exploration Ltd v Northstar Energy Corp* (1993), 15 Alta LR (3d) 200

Practical Takeaways on Part I

- Evidentiary issues are difficult to navigate – litigators walk a fine line in presenting evidence

- Courts will generally allow a broad range of evidence and give it appropriate weight

- Parties to transactions should be aware that evidence pre-contract, including negotiations can be admissible in certain circumstances

- Objective records evidencing the parties intentions is likely the best evidence

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PRE-CLOSING DISPUTES

- **Issues can arise in the Interim Period prior to Closing**

- **Examples:**
  - A party refuses to close
  - A party cannot satisfy a contractual obligation in the interim period
  - A ROFR obligation cannot be satisfied
  - The AER refuses a licence transfer

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Obligations in the Interim Period

- **Express obligations in the contract**
  - Right to terminate contract depending on nature of the breach
    - Fundamental breach v ordinary breach
      - See for example, *2068895 Ontario Inc v Snyder*, 2012 ONCA 757 where an error on a statement of adjustments prior to Closing did not justify a refusal to close the transaction
  - Remedy post-closing in damages
  - MAC clauses
    - *Stetson Oil & Gas Ltd v Stifel Nicolaus Canada Inc,* 2013 ONSC 1300

- **Overarching duty of honest performance**
  - *Bhasin:* obligation not to lie or knowingly lie or mislead one another
  - Example in the transaction context: dishonestly withholding relevant information from purchaser during due diligence process
  - Strict communication protocol can mitigate risk

ROFRs

- **High stakes, many cases in the energy context**

- **Take-aways from the litigation perspective?**

- ***Blaze Energy Ltd v Imperial Oil Resources*, 2014 ABQB 326**
  - Courts can resolve issues quickly (Statement of Claim filed April 24, 2014, decision issued May 30, 2014)
  - Agreed statement of facts, affidavit evidence, no questioning or *viva voce* evidence
  - Timing? Claim should be commenced prior to expiry of ROFR notice period

- ***Northrock Resources v ExxonMobil Canada Energy*, 2017 SKCA 60**
  - Case involving alleged breach of the duty of good faith
  - Evidence transaction structured for tax reasons (and not as alleged to avoid ROFR)
  - Good record keeping by ExxonMobil evidenced intention for sale

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POST-CLOSING DISPUTES

- ## Caveat emptor

  - Absent specific contractual protections, parties have limited recourse to commence claims after Closing

  - Contractual interpretation key to determining disputes

- ## Three types of common disputes we discuss

  - Disputes over definition of the "Assets" conveyed

  - Disputes over mechanics of indemnity

  - Disputes over representations and warranties

"Asset" Disputes

- **Often arises in disputes over responsibility for environmental liability**

"That, my friends, is a hot potato."

Environmental Disputes

- **Energy PSAs often include broad definitions for "Assets" which is made up of three commonly used terms:**
  - "Petroleum and Natural Gas Rights"
  - "Tangibles"
  - "Miscellaneous Interests"

- **However, in practice these have not been interpreted as catch-all provisions transferring liabilities to the purchaser**

- ***Anadarko:*** abandoned battery not a "Tangible" or "Miscellaneous Interest"

- ***Talisman v Esprit:*** Sulphur stockpiles not included as "Miscellaneous Interests" or as "Tangibles"

Nexxtep: How low did the PSA go?

- Issue was whether transaction properly included "Petroleum and Natural Gas Rights" associated with a specific producing zone for a particular vertical well

- PSA contemplated the sale of "PNG base of Mannville to base Pekisko" for the relevant lands as being part of transaction
  - Pre-sale parties understood vertical well producing sweet gas from zone above the Mannville
  - Post-closing, parties became aware that vertical well was producing from below the Mannville

- Nexxtep sued Talisman in trespass and conversion

- Court held that Nexxtep had purchased Talisman's entire interest in the lands below the base of the Mannville but excluding the pool from which the vertical well was producing.

Indemnities

- **Energy PSAs often have multiple indemnities**
  - For example a general indemnity, an abandonment and reclamation indemnity, and an indemnity specific to environmental claims

- **Disputes generally arise over:**
  - Scope of the indemnity
  - Triggering event
  - Targeted losses

- **Indemnities are strictly interpreted and are "untrammeled by any special rule"**
  - *EnCana Oil & Gas Partnership v Ardco Services Ltd*, 2017 ABCA 401 at para 17

Reps and Warranties

- **Is there a difference between a representation & a warranty?**
  - Maybe…
    - Representations may import tortious liability
    - Warranties are simple contractual terms

- **Why does it matter?**
  - Damages calculated on tort vs. contract standard
  - Reliance
    - Element of misrepresentation but not for breach of contract
    - If you know a rep & warranty is untrue prior to Closing and choose to Close, can you sue after the fact?
      - On tort standard, no
      - On contract standard, yes
  - Sandbagging clauses

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LIMITATIONS ON RECOVERY

Survival Periods for Reps & Warranties

- **Survival Periods for Reps & Warranties**
    - *Limitations Act* provides you cannot shorten the statutory limitation period to bring a claim
        - 2 year discoverability
        - 10 year ultimate limitation period

    - Section 7: "an agreement that purports to provide for the reduction of a limitation period provided by this Act is not valid"

    - But survival periods for reps & warranties can have the effect of limiting the time to bring a claim

    - Are they invalid?

Survival Periods for Reps & Warranties

NOV v Enerflow

- Clause in question provided that claim on the reps & warranties did not survive the "expiration date" of 2 years after closing.

- Court found the clause was not offside the limitation period:

    "[t]hat is not to say NOV could not still bring a claim for breach of representation or warranty after May 11, 2014; however, such claims would be hopeless if the representations and warranties on which they were based had expired."

- Would the decision have been different if different language had been used?

    - CAPL PTP: "CAPL PTP: "each Party <u>waives any rights it may have at law </u>or otherwise to commence a claim or action for breach of a representation or warranty after that period."

    - Waiver of legal rights seems conceptually different than an expiration of a representation and warranty?

Special Limitation Period for Environmental Contamination Claims

- **EPEA allows for extension of ordinary limitation periods under the *Limitations Act* for claims relating to environmental contamination**

- **Section 218 EPEA sets out factors for courts to consider:**
  - when the adverse effect occurred;
  - whether the adverse effect ought to have been discovered by the claimant through the exercise of due diligence;
  - whether the defendant will be prejudiced from maintaining a defence to the claim on the merits; and
  - any other relevant criteria.

- **2 step test set out in *Lakeview Village Professional Centre Corporation v Suncor Energy Inc*, 2016 ABQB 288**

  1. Consider evidence on section 218 factors

  2. If insufficient evidence on section 218 factors, has the claimant shown a good arguable case for an extension of the limitation period subject to a final determination at trial?

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Limitation of Liability Clauses

- **Many different forms of clauses that can limit liability in different ways:**
  - exclude liability for certain types of claims (for example, an entire agreement clause that excludes liability for pre-contractual representations)

  - exclude liability for specific types of damages (for example by excluding liability for consequential damages)

  - provide an overall aggregate monetary cap on liability

  - exclude claims being brought at a particular point in time (for example survival periods for representations and warranties)

- **Enforceability - Test set out by the SCC in *Tercon***
  - (1) Does the exclusion clause applies to the circumstances?

  - (2) Was the exclusion clause unconscionable at the time it was entered into?

  - (3) Should the court should refuse to enforce a valid and applicable exclusion clause because of the existence of overriding public policy?

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Challenging limitation of liability clauses in the energy context

- **Likely difficult to challenge on the basis of unconscionability or public policy**
  - Usually sophisticated parties, negotiating and drafting with the assistance of legal counsel

- **Challenges to the scope of the clause are more likely to be successful**
  - i.e. arguing that the clause does not apply to the particular losses alleged

- **Limitation of liability clauses interpreted like any other contractual term**
  - Back to ordinary principles of contractual interpretation
  - Can cover negligence or misrepresentation

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Conclusion

- **Overall take-aways:**

  - Contractual interpretation is key

  - Careful attention to terms and their interplay at drafting stage is key

  - Litigation can quickly become complicated and expensive

  - Procedural and evidentiary issues are often in a grey zone

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Questions?

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